

## MEMORANDUM

**To:** The Corporations Committee of the Business Law Section of the State Bar of California

**From:** Wilson Sonsini Goodrich & Rosati, P.C.

**Date:** February 10, 2006

**Re:** **Proposed NVCA venture financing forms for California corporations**

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### Background

We would like to thank you for the opportunity to comment on the proposed NVCA venture financing forms for California corporations. We understand that these forms were prepared with the goals of expediting the process of completing venture financing transactions and reducing associated costs. These goals have always been a priority for our firm as we strive to serve our clients in the most efficient manner possible.

We recognize the importance of effective forms, and we have kept and updated our own annotated forms for the benefit of our clients. Although we have our own forms, we encourage all efforts to promote further efficiency in the practice of law. We have therefore had a number of our attorneys dedicate time to reviewing and discussing the NVCA forms in an effort to develop a thoughtful response to the request for comments.

We have several general observations regarding the NVCA forms as well as a number of more specific comments on the documents themselves. We provide our general observations below. Because of the number and extent of our more specific comments, we have provided them in a separate correspondence to the committee.

### General observations

It is apparent that the NVCA forms were thoughtfully prepared. Nonetheless, we want to caution anyone using the forms that the forms may not completely accomplish the stated goal of reducing the time and cost of financings.

*A more balanced approach may help to expedite negotiations*

We are concerned that the NVCA forms display an investor-favorable posture that may serve to lengthen rather than expedite negotiations. An example is the option to make founders personally liable for certain representations in the form of stock purchase agreement. In our experience, subjecting founders to this type of liability is highly unusual, and it would be reasonable to expect

founders to strongly resist efforts to subject them to personal liability. There are several other instances where the forms include investor-favorable provisions that are atypical or rare, and we question whether the forms adequately balance the various investor-favorable provisions that appear in the forms with company-favorable provisions. In addition, certain investor-favorable provisions that, in our experience, appear in only a minority of deals are presented as standard terms in the forms (*e.g.*, redemption provisions). Moreover, it is not clear that the NVCA forms adequately account for the fact that certain investor-favorable provisions in the forms may place undue burdens on the company (*e.g.*, requiring director approval for a number of different company actions) or may prove difficult to interpret or apply (*e.g.*, broad waivers of corporate opportunity).

The investor-favorable aspects of the forms extend beyond the more specific items that we have identified in our separate correspondence to you. In many cases, investor rights are phrased broadly, and exceptions are defined narrowly. Investor-favorable options are often presented more prominently, and company-favorable options are limited relative to the number and nature of investor-favorable options that are included. In addition, many of the choices with respect to what language is bracketed in the text and what language is included in footnotes tend to reflect a pro-investor approach.

Because of the overall posture of the forms, we are concerned that use of the NVCA forms for drafting financing documents will tend to result in documents that favor investors at the expense of the company. While it is not in itself problematic to have investor-favorable forms, we are concerned that it will work against the stated goal of reducing the time and expense associated with negotiating financing transactions. Based on our experience representing companies and investors in venture financing transactions, we believe that more balanced forms better serve the interests of all parties in completing negotiations in an expeditious and fair manner.

*The NVCA forms should account more for West Coast practice*

It appears that alternative provisions more typically applicable to East Coast transactions tend to appear as the default provisions in the forms, while alternatives noted as more typically applicable to West Coast transactions are often relegated to the footnotes. We question whether this is appropriate, given that these particular forms are intended for the California market. Moreover, we feel that it is appropriate to use West Coast market practice as the standard generally, given that California alone represents over 40% of the venture financing transactions nationwide.

*Forms do not eliminate the need for negotiation in venture financings*

Unlike certain documents that can be signed in the form provided, venture financing documents will always require some negotiation. While a number of provisions in venture financing documents have become reasonably standard, many others remain subject to negotiation on a deal-by-deal basis, and what may be viewed by some as being standard may not be viewed the same way by others. Settling on these open provisions involves decisions that will be more or less favorable to either side in these transactions. Thus, they will be negotiated in every transaction. This is reflected in the NVCA forms themselves, which include a number of provisions in brackets and leave a

number of issues open, as we believe is proper. The resolution of these open points is a normal part of the financing process and will take time, even if the documents were based on standard forms.

*Drafting and negotiating documents account for only a limited portion of the time and cost of a financing*

In our experience, the initial drafting of the documents and the negotiation and resolution of typical provisions do not usually comprise the most significant aspects of the time and expense incurred in venture financings. The substantial majority of the time is generally spent on due diligence, resolution of matters found in the due diligence, negotiation of economic terms, negotiation of terms particular to the financing, and the ministerial (though important) process of circulating documents for review, responding to questions and comments regarding procedural matters, and securing executed signature pages. The work involved is generally specific to the particular company and transaction, and the use of standard form documents will not result in time savings in these areas.

*There are already a number of well-accepted forms being used*

It is unclear whether the marketplace will benefit from another set of forms. Our firm has standard forms that reflect our best judgment as to what will best serve our clients, which include companies and investors. Many other firms have standard forms as well, and there are annotated forms that appear in treatises. We also understand that the ABA may be producing its own set of venture financing forms.

In our experience, the standard aspects of venture financing documents are already fairly consistent among the forms in use. Moreover, within the particular legal communities that regularly service technology companies and venture funds, law firms are generally very familiar with the forms of other firms, and there are efficiencies based upon existing forms and market practice. It is not clear that introducing another set of forms will increase or even maintain that level of efficiency.

*Standardized forms have limited benefit after the initial venture financing round*

The use of forms has limited effect on the cost and expense of financings after the initial financing. In almost all cases, for efficiency purposes and to leverage prior negotiations between the company and investors from earlier rounds, the documents for financing rounds after the first one are based on those used in the previous round, not new standardized forms.

*The forms may not remain sufficiently up-to-date*

We are concerned that the proposed forms may not be updated on a timely basis. Changes in state corporate law may require changes to ensure compliance with law or may otherwise spur changes to account for new opportunities and risks. In addition, evolving market practice and changing market conditions can significantly change the types of terms and provisions included in venture financing deals. Accordingly, to remain effective, the forms themselves must continually

evolve, as we have found it necessary to make regular updates to our own forms. It is not clear whether there is an effective mechanism to capture necessary or advisable changes to the NVCA forms on a timely basis. Even annual assessments may not be adequate.

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We commend the technical expertise and focus that has been applied to the NVCA forms. As mentioned earlier, it is evident that the NVCA forms were thoughtfully prepared. However, we feel that the NVCA forms would benefit from improvements that more effectively reconcile the interests of investors and companies in financing transactions. We have focused on this in developing and maintaining our own forms, and we feel that providing a balanced starting point serves the interests of all parties involved in the financing.